***United States Court of Appeals***

***for the Second Circuit***


# APPELLEE'S BRIEF

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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IN THE MATTER OF :

AIRSPUR CORPORATION, a/k/a : Docket No. 75-7532
AIRSPUR, NEW YORK, Bankrupt.
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# BRIEF OF APPELLEES MERCANTILE COMMERCE COMPANY, OHIO REAL PROPERTY, INC., AND BANKERS TRUST COMPANY AS TRUSTEE


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BRIEF OF APPELLEES MERCANTILE COMMERCE COMPANY,
OHIO REAL PROPERTY, INC., and
BANKERS TRUST COMPANY AS TRUSTEE

## STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. WHETHER THE DISTRICT COURT CORRECTLY DECIDED THAT THE BANKRUPTCY COURT LACKED SUMMARY JURISDICTION TO ENTERTAIN COUNTERCLAIMS OF CORPORATE MISMANAGEMENT ASSERTED BY THE BANKRUPTCY TRUSTEE AGAINST NOTE CLAIMANTS.

2. WHETHER THE DISTRICT COURT CORRECTLY DECIDED THAT, EVEN IF THERE HAD BEEN SUMMARY JURISDICTION, THE BANKRUPTCY COURT SHOULD HAVE DISMISSED THE TRUSTEE'S

COUNTERCLAIMS IN THE EXERCISE OF DISCRETION BECAUSE OF THE TRUSTEE'S PLENARY ACTION IN THE NEW YORK STATE SUPREME COURT ASSERTING IDENTICAL CLAIMS AGAINST CLAIMANTS AND OTHER PARTIES NOT BEFORE THE BANKRUPTCY COURT.

## STATEMENT OF THE CASE

This is an appeal from an order of the Honorable Charles H. Tenney of the United States District Court for the Southern District of New York, dated August 6, 1975. That order reversed an order of the Honorable Roy Babitt, Bankruptcy Judge, dated August 29, 1974, denying motions by Mercantile Commerce Company ("Mercantile"), Ohio Real Property, Inc. ("Ohio") and Bankers Trust Company as Trustee ("Bankers Trust"), jointly referred to herein as the "Note Claimants," to dismiss counterclaims asserted by the bankruptcy trustee of Airspur Corporation (the "Trustee" or "Airspur Trustee") in the Bankruptcy Court.

In his memorandum opinion (316a et seq.), the District Court held that the Bankruptcy Court lacked summary jurisdiction to entertain the Airspur Trustee's counterclaims against Mercantile, Ohio and Bankers Trust. The District Court also found that in the exercise of its discretion the Bankruptcy Court should have dismissed the counterclaims against the Note Claimants because of the Airspur Trustee's assertion against each of them of identical claims in a plenary action brought

by him in the New York State Supreme Court. Since the District Court found that the same considerations required dismissal of the counterclaims against each of those three parties, they submit this brief jointly.

In addition, Bankers Trust and Ohio assert further grounds for dismissal of the Airspur Trustee's counterclaims which the District Court Judge found unnecessary to reach because of his determination of the issues discussed herein and because, while briefed in the Bankruptcy Court, those grounds had not been addressed by the Bankruptcy Judge (328a n.4). These grounds are set forth separately in individual briefs submitted by those parties.

## STATEMENT OF RELEVANT FACTS

Airspur, a small commuter airline, was adjudicated a bankrupt on August 29, 1970. Ohio, Mercantile, and Bankers filed proofs of claim in the amount of $114,750, $375,000, and $1,875,000 respectively, each based on a note of Airspur representing a loan to Airspur. On September 6, 1972 the Airspur Trustee filed three documents, each entitled "Objection to Claim and Offsets, Cross-Claim and Request for Affirmative

Judgment" and each addressed to one of the Note Claimants (herein denominated "counterclaims").

The counterclaims against Ohio, Mercantile, and Bankers Trust are essentially identical. None of them makes reference to the claims filed by the Note Claimants. None of them denies the validity of the notes upon which the proofs of claim are based. Instead, the counterclaims describe a series of transactions entered into by Airspur beginning in late 1969, which are alleged to have resulted in "financial disaster and the bankruptcy of Airspur". Each of the counterclaims seeks recovery of $6,208,904.

As the basis for recovery, each counterclaim alleges:

(a) that the Note Claimant was a stockholder of Airspur;*

(b) that the Note Claimant entered into an agreement collectively with Airspur and the other stockholders of Airspur, under the terms of which a certain

* In the case of Mercantile, 12,500 shares; of Ohio, 3750 shares; of Bankers Trust 62,500 shares.

group of stockholders, including the Note Claimant, was to exercise certain controls over Airspur;*

(c) that the Note Claimant designated an agent to act on the Board of Directors of Airspur. In the case of Mercantile and Ohio, the director is identified as one Richard Mersinger; in the case of Bankers Trust, he is identified as Leonard E. B. Andrews;

(d) that Mersinger (Andrews) was elected to the Board of Directors of Airspur;

(e) that Mersinger (Andrews) failed and omitted to perform his duties as officer and director of Airspur;

(f) that therefore the Note Claimant was negligent in failing to prevent the alleged mismanagement** which resulted in the bankruptcy of Airspur.

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* A correction of the Airspur Trustee's brief is called for. That brief refers to "The Assumption of Control of the Bankrupt By Appellees and Their Purchase of 50% of Bankrupt's Common Stock" (Trustee's Br. p. 7). This assertion is untrue. Nine stockholders, the "Class B" stockholders, acquired 50% of Airspur's stock. The Note Claimants are only three of those nine stockholders.

** The allegations of mismanagement relate to a contract under which Airspur was to purchase 20 Jetstream aircraft from Handley Page Aircraft, Ltd., a British corporation. The allegations specify the wrongful advance by Airspur

In the fall of 1972 Ohio, Mercantile and Bankers Trust moved to dismiss the Trustee's counterclaims. Their motions were argued and submitted on April 5, 1973. At the same hearing, on the application of counsel for the Airspur Trustee, the Bankruptcy Judge stayed the parties from proceeding with further discovery, then commenced by certain defendants, in a prior parallel action containing the same charges brought by the Airspur Trustee against them and thirteen others in the Supreme Court, New York County. On August 29, 1974, seventeen months later, the Bankruptcy Judge filed an opinion denying all of the motions of the parties before him. Having taken seventeen months to decide the motions of the Note Claimants, and having stayed discovery during that period in the substantially identical plenary suit brought by the Trustee, the Bankruptcy Judge in the same opinion directed that

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FOOTNOTE CONTINUED FROM P. 7

of approximately $1,000,000 and that Mersinger (Andrews) failed to investigate or inquire into the transaction. It is also alleged that Mersinger (Andrews) failed to prevent other actions of Airspur which resulted in additional waste of corporate assets, specifically, the expenditure of approximately $92,000.00 for an option to purchase the assets of Handley Page, and the entering into an agreement under which Airspur was to purchase Tradewinds Airlines, Inc. and Tradewinds Investment Co. from Berwind Corporation of Philadelphia for a total purchase price of $3,550,000.00.

discovery in the summary proceeding be completed in less than two months (315a).

Appeal was taken to the District Court by each of the Note Claimants, and on August 6, 1975 Judge Tenney filed a Memorandum and Order reversing the decision of the Bankruptcy Judge (316a). Judge Tenney held (322a) that the Bankruptcy Judge's conclusion was unwarranted by the case law, observing:

> "[O]ne can only conclude that the Note Claims and the counterclaims of fraud and mismanagement do not arise out of the same transaction or occurrence, so that the Bankruptcy Court has no power to decide the counterclaims on the merits." (323a)

The District Court also found that the pendency of the Trustee's state court action dictated dismissal:

> "The simultaneous determination of the same controversy in two forums, which raises the possibility of inconsistent determinations, would be a waste of both the bankrupt estate's limited resources and the two courts' time. Under the circumstances, the wiser policy would have been to acknowledge lack of jurisdiction over the counterclaims and permit the speedy adjudication of the entire dispute in the state court." (325a)

Rather than prosecuting his state court action, now pending for nearly three and one-half years, and stayed by his own motion, the Trustee has chosen to prosecute this appeal.

## ARGUMENT

### I

### THE DISTRICT COURT CORRECTLY HELD THAT THE BANKRUPTCY COURT LACKED SUMMARY JURISDICTION TO ADJUDICATE THE AIRSPUR TRUSTEE'S COUNTERCLAIMS AGAINST THE NOTE CLAIMANTS

In addition to seeking denial of the claims filed by the Note Claimants, the Airspur Trustee is seeking through his pleading to recover from them in the Bankruptcy Court an affirmative judgment in the amount of $6,208.904. No jurisdictional basis for seeking such relief is set forth in the pleading.

It is fundamental that "[t]he jurisdiction of the district courts sitting in bankruptcy is limited to matters conferred by statute or implied therefrom." 1 Collier, Bankruptcy ¶2.04. Otherwise, §23(b) of the Bankruptcy Act, 11 U.S.C. §46(b), requires that suits by the trustee

> "shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, unless by the consent of the defendant,

except as provided in sections 60, 67 and 70 of this Act."*

The jurisdiction of courts in bankruptcy is set forth in Section 2 of the Bankruptcy Act, 11 U.S.C. §11, and insofar as here pertinent, the bankruptcy courts are invested with jurisdiction to allow or disallow claims. Bankruptcy Act §2(a)(2), 11 U.S.C. §11(a)(2).

> "Thus where it is necessary to consider a counterclaim in order to 'allow', 'disallow' or 'reconsider' a claim, it follows that the counterclaim is subject to the summary jurisdiction of the Bankruptcy court." In re Behring and Behring, 445 F.2d 1096, 1098 (5th Cir.), cert. denied, 404 U.S. 991 (1971).

For example, consent to summary jurisdiction involving counterclaims seeking return of preferences or fraudulent conveyances is founded upon filing a proof of claim, since §57(g), 11 U.S.C. §93(g), requires that claims of creditors who have received voidable preferences or conveyances not be allowed unless surrendered. E.g. Katchen v. Landy, 382 U.S. 323 (1966); Inter-State National

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* Section 60 relating to preferences, §67 relating to fraudulent transfers, and §70 relating to title to property of the debtor are not applicable to the claims here in issue.

Bank v. Luther, 221 F.2d 382 (10th Cir. 1955), appeal dismissed 350 U.S. 944 (1956). And, since §68 of the Bankruptcy Act, 11 U.S.C. §108, requires set-off of mutual debts and credits, claims by the trustee against the claimant arising out of the same transaction or occurrence, which would be the subject of a compulsory counterclaim under Fed.R.Civ.P. 13(a), are also within the summary jurisdiction of the Bankruptcy Court. E.g., Chase National Bank v. Lyford, 147 F.2d 273 (2d Cir. 1945); Florance v. Kresge, 93 F.2d 784 (4th Cir. 1938); In re Seatrade Corp., 297 F. Supp. 577 (S.D.N.Y.), appeal dismissed, 418 F.2d 9 (1969).

But

> "where the trustee attempts to obtain ... a judgment for a balance against the plaintiff, or other affirmative relief, the problem becomes twofold: (1) does the bankruptcy court have power to grant an affirmative jdugment in summary proceedings; (2) has the plaintiff, by filing his petition or otherwise, consented to the exercise of such jurisdiction? It appears agreed that a bankruptcy court does not have the jurisdiction to render such a judgment in favor of the bankrupt estate without consent." 4 Collier, Bankruptcy ¶68.20

Thus summary jurisdiction exists when a counterclaim by the trustee is compulsory, arising "out of the

transaction or occurrence that is the subject matter of the opposing party's claim", Fed.R.Civ.P. 13(a).* On the other hand, permissive counterclaims, not involving the same transaction or occurrence, require independent jurisdictional ground. 4 Collier, Bankruptcy ¶68.20[3]. Transactions or occurrences which are separate and distinct cannot be considered as a part of the process of allowing or disallowing a claim, and consequently summary jurisdiction does not exist. See In re Behring and Behring, supra, wherein the Fifth Circuit held that the filing of a claim upon a transaction did not confer summary jurisdiction to determine a counterclaim based upon a separate transaction occurring a month later, and that the filing of the claim could not be construed as implying consent to adjudication of anything more than

* Another error in the Trustee's brief warrants correction. The Trustee argues that summary jurisdiction would lie if the claim of the Trustee and the claims of the Note Claimants "arose out of the same transaction or series of transactions." (Trustee's Br. p. 7) (Emphasis supplied). See also Trustee's Br. pp. 2, 15. This formulation is wrong. Summary jurisdiction exists when a counterclaim arises "cut of the transaction or occurrence" giving rise to the claim , F.R.Civ.P. 13(a). No authority, to our knowledge, has formulated the rule in terms of "transaction or series of transactions."

was necessary to determine the validity of its claim. Id. at 1099. See also In re Eakin, 154 F.2d 717 (2d Cir. 1946); In re Industrial Associates, Inc., 155 F. Supp. 866 (E.D. Pa. 1957).

The objections and claims for affirmative relief in the instant case are based on asserted mismanagement of Airspur beginning at the end of 1969. The claim for each Note Claimant is based upon a note executed by Airspur for money loaned in July, 1969, and is not otherwise disputed. The determination of the facts as to whether the money was loaned and has or has not been repaid has no relevance to the questions of management or mismanagement of the company occurring after the loan was made. This was correctly discerned by the District Court Judge, who observed:

> "The transaction upon which the Note Claims are based is the execution of the Purchase Agreement in July 1969. The counterclaims filed by the Trustee, on the other hand, are based upon a series of unrelated financial maneuvers which occurred after that agreement had been executed and performed." (323a)

The loans in July 1969 were not the same "transaction or occurrence" as the subsequent business transactions of Airspur of which the Trustee complains. Virtually the entire business history of Airspur appears to be the subject matter of the objections; the Note Claimants' proof of claim, as the District Court correctly held (323a), are made for money loaned before any of those events occurred. There is no logical connection between the two.

Whether claims arise out of the same transactions or occurrences depends upon their logical relevancy. See generally, 3 Moore, Federal Practice ¶13.13. This logical relevency is entirely lacking here. The same evidence will neither support nor refute the claims for money due upon the notes, and the counterclaims for asserted failure to properly manage the corporation allegedly imposed by the separate Stockholders' Agreement. Determination of the claims for money loaned will not bar by res judicata the prosecution by the Trustee of his plenary proceeding alleging mismanagement. As the District Court found:

> "Clearly, determination of the validity of the Note Claims will not necessitate any investigation into the facts alleged in the

> Trustee's counterclaims. To state it another way, the facts alleged in the Trustee's counterclaims have no relevancy to the question of whether the bankrupt is obligated to the Note Claimants on the Notes which they now hold." (324a)

The authorities demonstrate that the Bankruptcy Court does not have summary jurisdiction to entertain the counterclaims asserted by the Airspur Trustee. In re Majestic Radio & Television Corp., 227 F.2d 152 (7th Cir. 1955), cited by the District Court, is closely in point. The claimant, one Curtis Franklin, filed a proof of claim in the amount of $1,481.99 for goods sold and delivered to the bankrupt. The bankruptcy trustee asserted an off-set and counterclaim in the amount of $442,067.25, based on alleged breaches of fiduciary duty by Franklin during the time he had been a member of the Board of Directors of the bankrupt.

The Court found that Franklin's filing of his claim was not consent to summary jurisdiction by the bankruptcy court of the counterclaim based upon the breach of fiduciary duty. The court stated at 156:

> "[N]o case has been cited, nor have we found any, in which it has been held that a Bankruptcy Court has acquired such jurisdiction of a setoff or counterclaim because the counter-defendant had filed a proof of claim arising out of a completely different subject matter. . . .

* * *

> "It is obvious that filing a claim in a Bankruptcy Court is an implied consent to summary adjudication by that court of any counterclaims based upon the subject matter of that claim. . . . But it does not follow that by filing a claim a litigant has impliedly consented to the summary adjudication in the Bankruptcy Court of a counterclaim arising out of subject matter which has no relation to his claim."

Noting that the jurisdiction of the bankruptcy court was limited by statute unless consent is otherwise given, the Court held that "the filing of his proof of claim did not constitute his [the claimant's] implied consent to be sued on an alleged cause of action arising out of a different subject matter." Ibid.

In In re Los Angeles Trust Deed & Mortgage Exchange, 464 F.2d 1136 (9th Cir.), cert. denied, 409 U.S. 1064 (1972), the court confirmed that summary jurisdiction does not exist over claims such as those asserted against the Note Claimants here. The claimants had separately negotiated loan and joint venture arrangements with the bankrupt with respect to seven tracts of land, and filed claims in the bankruptcy proceeding relating to loan on two of seven tracts. The trustee sought an accounting of profits earned on the five other

tracts. It was contended that summary jurisdiction existed to determine the counterclaim. On review of the Bankruptcy Act, its underlying policies, and pertinent authorities, the court concluded that the referee had no jurisdiction over the counterclaim, which was unrelated to the transactions upon which the creditors' claims were based. See also In re Professional Health Services, Inc., summarized in CCH Bankruptcy L. Rep. ¶64,535 (S.D.N.Y. 1972), in which Judge Frankel held that Section 68 of the Bankruptcy Act did not give summary jurisdiction to decide the validity of a bankrupt estate's claim as a setoff when the basis of the offset was a permissive counterclaim.

Further authority is found in the decision of Judge Wyatt in In re Airspur Corp., 70 B 577 (Oct. 31, 1973), reversing the decision of the Bankruptcy Judge and holding that the filing of a claim in the instant bankruptcy proceeding by Northwest Industries, Ltd. in the amount of $2,795 for painting an aircraft did not confer summary jurisdiction over a counterclaim by the Airspur Trustee against Northwest in the amount of $1,178,904 for "aiding and abetting" the actions alleged herein. The counterclaim did not arise out of the same transaction.

The cases cited in the Trustee's brief need no extended discussion, for none of them supports the Trustee's position. In re Solar Mfg. Corp., 200 F.2d 327 (3d Cir. 1952), cert. denied, 345 U.S. 940 (1953) (Trustee's Br. p. 18) and Alexander v. Hillman, 296 U.S. 222 (1935) (Trustee's Br. p. 16 et seq.) both involved claims by a trustee for return of voidable preferences or funds misappropriated from the corporation. The basis of implied consent to summary jurisdiction was accordingly the possession by the claimant of property which the trustee sought to bring into the estate, a jurisdictional ground undoubted since Katchen v. Landy, 382 U.S. 323 (1966), and not in issue here.

Florance v. Kresge, supra, (Trustee's Br. p. 18) is of no use to the Trustee. That case held that receivers could assert a counterclaim against a claimant based on the same contract out of which the claim had arisen.

The Trustee's reliance on In re Seatrade Corp., supra, (Trustee's Br. p. 18 et seq.), is also misplaced. Judge Edelstein, while speculating whether a bankruptcy court should not be permitted to exercise summary

jurisdiction over permissive or unrelated counterclaims, expressly held that summary jurisdiction existed in that case precisely because the trustee's claim was in the nature of a compulsory counterclaim. In Seatrade an insurer filed a claim for premiums under certain policies and the trustee sought reimbursement for claims and attorneys' fees paid by the bankrupt which he asserted were covered under those same policies. Since the claims for which reimbursement was sought had already been paid, the issues before the court were narrowed to the duties of the parties under the policies.*

The claims of each of the Note Claimants are proved by the notes themselves each of which evidences a money obligation of the bankrupt. The loans and validity

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* This Court has intimated that summary jurisdiction may not necessarily have followed in Seatrade even from the fact that the claim and counterclaim arose from identical contracts. The Second Circuit dismissed an appeal from Judge Edelstein's decision on the ground that the order was not appealable. However, the Court did not indicate approval of that ruling, and questioned the decision, stating at 418 F.2d 9, 11, that "In our case, the claims of the creditor and of the trustee do not appear to be necessarily interrelated."

of the notes are not disputed. The Trustee's counterclaims, on the other hand, require proof of supposedly negligent performance by directors of Airspur long after the money was loaned, which the Trustee seeks to impute to the Note Claimants. The transactions concerning which the directors are alleged to have been negligent were (1) loans to a distributor of an English aircraft manufacturer, (2) payment by a subsidiary of Airspur of a deposit for an option and (3) an agreement to acquire two subsidiaries of the Berwind Corporation. The Note Claimants were not parties to or participants in those transactions, and the counterclaims contain no allegation that they were.

The slender connection upon which the Airspur Trustee seeks to append summary jurisdiction is the Agreement Among Stockholders entered into at the same time the loans were made. The Trustee characterizes his counterclaims as alleging some theory of breach of that separate agreement (through the counterclaims nowhere specify--nor could they--any breach and nowhere state what provision of that agreement is supposed to have

been breached). That agreement and the agreement under which the notes were acquired (the "Purchase Agreement") are then asserted to be in fact parts of a single transaction. From this the Trustee draws his conclusion that the counterclaims arise from the "same transaction" as the note purchases. The reasoning is specious, and based on gross mischaracterizations of the documents involved.

To eliminate any confusion regarding the Agreement Among Stockholders resulting from the mischaracterization of it by the Trustee (some of which were adopted in the Opinion of the Bankruptcy Judge, which in turn has been cited in the Trustee's brief) it may be well to consider just what that document provides and what it does not provide:

1. The Agreement Among Stockholders is an agreement distinct from the Purchase Agreement under which the Note Claimants acquired Airspur's notes. The Agreement Among Stockholders is an agreement setting forth duties and rights among the Class A and Class B stockholders vis-a-vis one another relative to their stock holdings in Airspur; the Purchase Agreement establishes duties of Airspur toward

the lenders and Class B stockholders. Had the parties wished the rights and duties under the two agreements to be treated together, they could have executed a single agreement rather than two.

2. It is not true that the Purchase Agreement and the Agreement Among Stockholders "memorialized the purchase by the claimants of 50% of the stock of the bankrupt for $1,250,000, the loan of $3,750,000 to the bankrupt, the transfer of management and financial controls to the claimants, the election of three designees of claimants to the bankrupt's Board of Directors. . ." (Trustee's Br. p. 10). Under the Purchase Agreement nine parties (the Class B stockholders) agreed to purchase 50%of Airspur's stock and notes of Airspur totalling $3,750,000. The Note Claimants were but three of those nine parties. The Note Claimants received no right to designate three directors or, for that matter, any directors, to serve on Airspur's board; a majority of the Class B stockholders were permitted under the Agreement Among Stockholders jointly to nominate three directors, to be elected by all the stockholders (53a).

3. The Agreement Among Stockholders did not effect an "assumption of contro`" by or a "transfer of control" to or "the transfer of management and financial controls" to the Note Claimants, as erroneously asserted by the Trustee (Trustee's Br. pp. 10, 13).

4. The Agreement Among Stockholders contains terms covering the relationship among the stockholders. One looks in vain in that Agreement for any terms setting forth duties of the stockholders as "co-manages of the corporation" (Trustee's Br. p. 14). The statement in the opinion of the Bankruptcy Judge in support of his characterization that

> "In effect they [the Note Claimants] became co-manages of the corporation..." (Opinion of the Bankruptcy Judge (313a), quoted by Trustee's Br. p. 14)

and

> ". . . they became, as set forth above, its owners and managers of its business affairs as well." (Opinion of the Bankruptcy Judge (313a), quoted by Trustee's Br. p. 21)

are entirely without support in the Agreement Among Stockholders.

5. It is not true that "In another part of the same agreement, movants undertook to 'share equally in

the management of Airspur' and nominated directors to accomplish this purpose." (Trustee's Br. p. 19). The language quoted in the Trustee's Brief has been removed from its context, totally changing its import. The quotation is taken from one of the recitals at the beginning of the Agreement Among Stockholders and in its entirety the recital reads:

> "WHEREAS it is deemed to be in the best interests of Airspur and the Stockholders that provisions be made for continuity and stability of policy for Airspur and, to that end, that the Group A Stockholders and the Group B Stockholders share equally in the management of Airspur and the control of its policy to the extent and upon the terms and conditions herein stated, and that the Group A Stockholders be restricted in their power to sell Group A Stock;" (Emphasis supplied).

The recital refers to sharing of management only to that extent and as set forth in the substantive terms of the Agreement.*

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* The recital adds nothing to the substantive terms. In any event, a recital in a contract does not, as the Airspur Trustee's counsel erroneously suggested below (Tr. April 5, 1972, pp. 55-56), create duties under that contract. Ross v. Ross, 253 N.Y.S. 871, 872 (1st Dept. 1931), aff'd, 262 N.Y. 381 (1933) ("[t]he recitals in a contract form no part thereof and at most indicate but the purposes and motives of the parties."); Stabler v. Ramsay, 62 A.2d 464, 470 (Ch. Ct. Del. 1948).

5. It is not true that

> "The appellees bargained for and obtained for themselves the right to full control of the operations of the bankrupt." (Trustee's Br. p. 23).

And it is not true that

> "Moreover, the agreement also gave the Class B Shareholders the right to give their seal of benediction to all of the contracts and other actions entered into or taken by the directors." (Opinion of the Bankruptcy Judge (313a) quoted by Trustee's Br. p. 20).

The Agreement provided [¶1(a), that unless the prior written consent of a majority of the Class B stock was obtained, all of the Airspur stockholders would vote their shares against any proposal of three classes of transactions, and those transactions only: (i) amendments to the certificate of incorporation, (ii) sales or leases of all of the assets of the corporation or merger of Airspur into another corporation, and (iii) contracts or acts submitted by the board of directors for approval, i.e., a vote, by the stockholders. None of the transactions of Airspur alleged in the counterclaim, concerning which the Class B Stockholders are alleged to have been negligent, fell into any of those three categories.

Moreover, the Trustee's Brief appears to assume (pp. 6, 15) that by participating in a purchase of stock and notes as members of the Class B stockholders group, which agreed to the appointment of directors to Airspur's board, the Note Claimants somehow delegated agents to act for them in the management of the corporation. This novel proposition (for which the Trustee's Brief cites no authority, and which, indeed, was not briefed or argued below) is at variance with the elementary principles that directors do not derive their powers from the parties electing them, and that their duties are to act on behalf of the corporation on the basis of their individual judgment. See, e.g., Manson v. Curtis, 223 N.Y. 313, 119 N.E. 559 (1918).

The Trustee's position is moreover based on an unstated assumption which examination shows to be faulty. He urges (Trustee's Br. p. 6) that summary jurisdiction exists because the mismanagement asserted was a breach of the Agreement Among Stockholders. Yet the counterclaims nowhere allege acts constituting a "breach"; and nowhere do they say what provision of that Agreement is

supposed to have been breached. Indeed, this appears nowhere in the Trustee's Brief. Even if one were to concede for purposes of argument that the Note Claimants were somehow guilty of or chargeable with mismanagement of Airspur, it is nowhere alleged (nor could it be) that such conduct constituted a breach of the agreement that is supposed to be the linchpin of summary jurisdiction.

II

THE DISTRICT COURT CORRECTLY HELD THAT THE COUNTERCLAIMS SHOULD HAVE BEEN DISMISSED IN THE EXERCISE OF DISCRETION

As the District Court correctly discerned (325a), "Under the circumstances, the wiser policy would have been to acknowledge lack of jurisdiction over the counterclaims and permit the speedy adjudication of the entire dispute in the state court." The Bankruptcy Judge either failed to consider his discretion or abused his discretion in refusing to dismiss the Trustee's counterclaims on this ground.*

Prior to filing the counterclaims in the Bankruptcy Court** the Airspur Trustee commenced a plenary action in the Supreme Court of the State of New York against

* The Bankruptcy Court in its opinion below failed even to advert to the arguments tendered as to whether summary jurisdiction, even if it existed, should be exercised in this case.

** Mercantile was served with the Summons and Complaint in the Supreme Court action on August 30, 1972; Ohio was served on September 5, 1972; Bankers Trust was served on September 1, 1972. The counterclaims were filed on September 6, 1972.

sixteen defendants, the allegations of which parallel the Trustee's counterclaims in the Bankruptcy Court. Jerome Lipper v. Leonard B. Andrews, et al., 25858/72 (188a). The Note Claimants are parties to the State Court action. As the District Court noted (324a), even if the Bankruptcy Court were to proceed to determine the merits of the counterclaims against the Note Claimants it would appear that the Trustee would still be required to prosecute his action in the State Court against the others named in that complaint.

The Trustee alleges in the counterclaims that, over a period of a year, two individuals, Warren B. Kraemer and K.R. Cravens, entered into a series of questionable transactions which resulted in Airspur's downfall. The asserted liability of the Note Claimants is alleged solely on the basis that they failed to supervise the actions of those two individuals. Neither of the individuals is before the Bankruptcy Court, but the two are defendants in the Trustee's State action. There appears no reason why the Trustee's claims should be tried piecemeal, with the attendant duplication of judicial proceedings and the possibility of inconsistent decisions.

This case is similar to In re Professional Health Services, Inc., supra, in which Judge Frankel affirmed Referee Herzog's dismissal of counterclaims on this ground. Judge Frankel observed:

> "Assuming there may be cases for summary adjudication of permissive counterclaims, this is not a proper one. The counterclaims are already pending in state court, where the receiver was long ago authorized to go and did go.
>
> * * *
>
> In a sense, then, the issue is whether the City's filing of its relatively minuscule claims justifies nullification of the steps taken under that authorization and the commencement of the whole business anew in a proceeding not likely to be 'summary' in fact before this Court."

Discovery proceedings were commenced in the Airspur Trustee's Supreme Court action before the Bankruptcy Judge stayed them, and nullification of those proceedings plus duplication in the Bankruptcy Court is not warranted.

As noted in Wikle v. Country Life Ins. Co., 423 F.2d 151, 154 (9th Cir. 1970):

> "A well recognized principle is that a bankruptcy court has discretion to decline to exercise summary jurisdiction even where such jurisdiction is present. In re Terrance Lawn Memorial Gardens, 9 Cir., 256 F.2d 398; In re Tyne, 7 Cir., 261 F.2d 249, 253. Where the

> jurisdictional issue is close or where complete relief could not have been awarded among the interested parties, summary jurisdiction may be properly declined. Sulmeyer v. Pfohlman, 9 Cir., 329 F.2d 915; Ford v. Magee, 2 Cir., 160 F.2d 457. And, certainly we think it was an appropriate situation for the referee to refuse to take the case."

The situation presented here is similar to that of In Re Wonderbowl, 456 F.2d 954 (9th Cir. 1972), cited by the District Court (326a-327a). In that case a trustee's claim of an alleged fraudulent scheme involving several respondents was dismissed on appeal as to twelve out of fifteen parties. There as here the trustee had commenced plenary litigation involving the same issues. Three parties remaining before the Bankruptcy Court moved for dismissal as to them in order to avoid multiplicity of litigation. The court reversed the Bankruptcy Court's denial of their motion, observing:

> "Summary jurisdiction may properly be declined, for example, where complete relief cannot be afforded among the interested parties . . . Plenary litigation may be preferable where important questions turning on nonbankruptcy law are involved."
>
> "The trustee's multifarious allegations of fraud raise numerous legal and factual issues as to whole series of events affecting the present status of the property. Each link in this chain may be crucial to the ultimate validity of claimed interests. A full analysis of the various transactions under controlling nonbankruptcy standards is essential. . . . The same

> issue is a central part of the plenary suit in federal court. All other contested transactions and some three dozen other affected parties are also before that court, which has unquestioned jurisdiction to decide the entire controversy and to order whatever relief may be appropriate, in equity or at law." 456 F.2d at 956.

In the instant case, had the District Court not intervened, the Bankruptcy Judge's failure to dismiss the counterclaims and permit the issues to proceed to judgment in the Supreme Court action would not only have resulted in duplication of litigation, but in the case of the Note Claimants would have been patently inequitable. A reading of the counterclaims reveals that the Airspur Trustee seeks to impose liability on Mercantile and Ohio through the person of Richard Mersinger an Airspur director; on Bankers Trust through Leonard Andrews, another Airspur director. It is by those two persons that the Note Claimants are alleged to have been negligent in managing Airspur. Yet the Trustee has not asserted and cannot assert a counterclaim against Mersinger or Andrews, for they are not before the Bankruptcy Court. Those parties are, however, among the sixteen defendants in the Trustee's Supreme Court action, as are other directors charged by law with the management of the corporation. Forcing the

Note Claimants to trial in the absence of the very persons through whom liability is alleged to attach, whose those persons are parties to the Trustee's parallel plenary action, would be prejudicial to the Note Claimants.

It would also be prejudicial to Mersinger and Andrews. In the improbable event liability were established against the Note Claimants in a summary proceeding, the Note Claimants could be expected to seek indemnification from Mersinger and Andrews either in the Supreme Court action or another action. It would be inequitable for Mersinger and Andrews to face claims for indemnification based on their actions or omissions, not having been parties to the adjudication establishing that the wrongs occurred and that the Note Claimants were liable for them.

The Trustee argues that the Bankruptcy Court should be permitted to retain jurisdiction because "the Trustee was not able to obtain jurisdiction of all [the defendants] in the State of New York" (Trustee's Br. p. 25). It is stated that the District Judge assumed that all of the named defendants were in fact parties (Trustee's Br. p. 25). The opinion of the District Judge reveals no such assumption. The ground of the District Court's conclusion

was expressly stated (324a-325a) to be that the two individuals alleged to be the prime movers in the wrongdoing are presently defendants in the Supreme Court action, but not before the Bankruptcy Court.

It is difficult to see how the absence of Grover Moore, Vernon Taylor, and Edward W. Breed (Trustee's Br. p. 32) from the State Court action will seriously impair the proceedings there. The sole allegations against those parties are that they were "officers and directors" (190a-191a) of the bankrupt, and that Moore was a vice president (197a). The persons alleged to be active wrongdoers remain defendants in the State Court action.*

That five of the Class B stockholders are not parties to the New York action (Trustee's Br. p. 32) in no way impairs the State Court in resolving the allegations of mismanagement.**

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* The Trustee nowhere explains why jurisdiction was not obtained over those individuals. It is difficult to see how this could have occurred, since the Trustee alleges that those individuals were officers and directors of Airspur, a Delaware corporation with its headquarters in New York City, and whatever acts and omissions those persons were responsible for most assuredly took place in the State of New York. If the Trustee simply neglected to serve those parties, he should not be heard to urge his omission as a ground for disregarding the pendency of his state court action.

** One may also fairly ask why those parties, who were

The Trustee further argues for the first time that the Bankruptcy Court has the power to equitably subordinate claims. He goes on to argue, citing two irrelevant cases, that "in circumstances such as exist in this case [which are not identified] (Trustee's Br. p. 25), the availability of that power is sufficient to support retention of jurisdiction in the Bankruptcy Court. One need not spend much time with this argument. Passing over the fact that the Trustee cites no authority for this proposition, it may be sufficient to point out that no demand has been made in the Trustee's counterclaims or anywhere else for equitable relief subordinating the claims of the Note Claimants. Even if such a demand had been made, the same state action and the same possibility of inconsistent adjudication would remain.

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Footnote continued -

also signatories of the Purchase Agreement and the Agreement Among Stockholders, and held stock and notes of Airspur, have not been made defendants in the Supreme Court action.

## CONCLUSION

For the reasons above stated the order of the District Court dated August 6, 1975 should be affirmed in all respects and the Trustee's counterclaims against Mercantile, Ohio, and Bankers Trust should be dismissed.

Respectfully submitted,

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